

31.205-5

that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

31.205-5 [Reserved]

31.205-6 Compensation for personal services.

(a) *General.* Compensation for personal services is allowable subject to the following general criteria and additional requirements contained in other parts of this cost principle:

(1) Compensation for personal services must be for work performed by the employee in the current year and must not represent a retroactive adjustment of prior years' salaries or wages (but see paragraphs (g), (h), (j), (k), (m), and (o) of this subsection).

(2) The total compensation for individual employees or job classes of employees must be reasonable for the work performed; however, specific restrictions on individual compensation elements apply when prescribed.

(3) The compensation must be based upon and conform to the terms and conditions of the contractor's established compensation plan or practice followed so consistently as to imply, in effect, an agreement to make the payment.

(4) No presumption of allowability will exist where the contractor introduces major revisions of existing compensation plans or new plans and the contractor has not provided the cognizant ACO, either before implementation or within a reasonable period after it, an opportunity to review the allowability of the changes.

(5) Costs that are unallowable under other paragraphs of this Subpart 31.2 are not allowable under this subsection 31.205-6 solely on the basis that they constitute compensation for personal services.

(6)(i) Compensation costs for certain individuals give rise to the need for special consideration. Such individuals include:

(A) Owners of closely held corporations, members of limited liability companies, partners, sole proprietors, or members of their immediate families; and

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(B) Persons who are contractually committed to acquire a substantial financial interest in the contractor's enterprise.

(ii) For these individuals, compensation must—

(A) Be reasonable for the personal services rendered; and

(B) Not be a distribution of profits (which is not an allowable contract cost).

(iii) For owners of closely held companies, compensation in excess of the costs that are deductible as compensation under the Internal Revenue Code (26 U.S.C.) and regulations under it is unallowable.

(b) *Reasonableness*—(1) *Compensation pursuant to labor-management agreements.* If costs of compensation established under "arm's length" labor-management agreements negotiated under the terms of the Federal Labor Relations Act or similar state statutes are otherwise allowable, the costs are reasonable unless, as applied to work in performing Government contracts, the costs are unwarranted by the character and circumstances of the work or discriminatory against the Government. The application of the provisions of a labor-management agreement designed to apply to a given set of circumstances and conditions of employment (*e.g.*, work involving extremely hazardous activities or work not requiring recurrent use of overtime) is unwarranted when applied to a Government contract involving significantly different circumstances and conditions of employment (*e.g.*, work involving less hazardous activities or work continually requiring use of overtime). It is discriminatory against the Government if it results in employee compensation (in whatever form or name) in excess of that being paid for similar non-Government work under comparable circumstances.

(2) *Compensation not covered by labor-management agreements.* Compensation for each employee or job class of employees must be reasonable for the work performed. Compensation is reasonable if the aggregate of each measurable and allowable element sums to a reasonable total. In determining the reasonableness of total compensation,

consider only allowable individual elements of compensation. In addition to the provisions of 31.201-3, in testing the reasonableness of compensation for particular employees or job classes of employees, consider factors determined to be relevant by the contracting officer. Factors that may be relevant include, but are not limited to, conformity with compensation practices of other firms—

- (i) Of the same size;
- (ii) In the same industry;
- (iii) In the same geographic area; and
- (iv) Engaged in similar non-Government work under comparable circumstances.

(c) [Reserved]

(d) *Form of payment.* (1) Compensation for personal services includes compensation paid or to be paid in the future to employees in the form of—

- (i) Cash;
- (ii) Corporate securities, such as stocks, bonds, and other financial instruments (see paragraph (d)(2) of this subsection regarding valuation); or
- (iii) Other assets, products, or services.

(2) When compensation is paid with securities of the contractor or of an affiliate, the following additional restrictions apply:

(i) Valuation placed on the securities is the fair market value on the first date the number of shares awarded is known, determined upon the most objective basis available.

(ii) Accruals for the cost of securities before issuing the securities to the employees are subject to adjustment according to the possibilities that the employees will not receive the securities and that their interest in the accruals will be forfeited.

(e) *Income tax differential pay.* (1) Differential allowances for additional income taxes resulting from foreign assignments are allowable.

(2) Differential allowances for additional income taxes resulting from domestic assignments are unallowable. (However, payments for increased employee income or Federal Insurance Contributions Act taxes incident to allowable reimbursed relocation costs are allowable under 31.205-35(a)(10).)

(f) *Bonuses and incentive compensation.*

(1) Bonuses and incentive compensation are allowable provided the—

(i) Awards are paid or accrued under an agreement entered into in good faith between the contractor and the employees before the services are rendered or pursuant to an established plan or policy followed by the contractor so consistently as to imply, in effect, an agreement to make such payment; and

(ii) Basis for the award is supported.

(2) When the bonus and incentive compensation payments are deferred, the costs are subject to the requirements of paragraphs (f)(1) and (k) of this subsection.

(g) *Severance pay.* (1) Severance pay is a payment in addition to regular salaries and wages by contractors to workers whose employment is being involuntarily terminated. Payments for early retirement incentive plans are covered in paragraph (j)(6) of this subsection.

(2) Severance pay is allowable only to the extent that, in each case, it is required by—

- (i) Law;
- (ii) Employer-employee agreement;
- (iii) Established policy that constitutes, in effect, an implied agreement on the contractor's part; or
- (iv) Circumstances of the particular employment.

(3) Payments made in the event of employment with a replacement contractor where continuity of employment with credit for prior length of service is preserved under substantially equal conditions of employment, or continued employment by the contractor at another facility, subsidiary, affiliate, or parent company of the contractor are not severance pay and are unallowable.

(4) Actual normal turnover severance payments shall be allocated to all work performed in the contractor's plant. However, if the contractor uses the accrual method to account for normal turnover severance payments, that method will be acceptable if the amount of the accrual is—

(i) Reasonable in light of payments actually made for normal severances over a representative past period; and

(ii) Allocated to all work performed in the contractor's plant.

(5) Abnormal or mass severance pay is of such a conjectural nature that accruals for this purpose are not allowable. However, the Government recognizes its obligation to participate, to the extent of its fair share, in any specific payment. Thus, the Government will consider allowability on a case-by-case basis.

(6) Under 10 U.S.C. 2324(e)(1)(M) and 41 U.S.C. 256(e)(1)(M), the costs of severance payments to foreign nationals employed under a service contract performed outside the United States are unallowable to the extent that such payments exceed amounts typically paid to employees providing similar services in the same industry in the United States. Further, under 10 U.S.C. 2324(e)(1)(N) and 41 U.S.C. 256(e)(1)(N), all such costs of severance payments that are otherwise allowable are unallowable if the termination of employment of the foreign national is the result of the closing of, or the curtailment of activities at, a United States facility in that country at the request of the government of that country; this does not apply if the closing of a facility or curtailment of activities is made pursuant to a status-of-forces or other country-to-country agreement entered into with the government of that country before November 29, 1989. 10 U.S.C. 2324(e)(3) and 41 U.S.C. 256(e)(2) permit the head of the agency to waive these cost allowability limitations under certain circumstances (see 37.113 and the solicitation provision at 52.237-8).

(h) *Backpay*. Backpay is a retroactive adjustment of prior years' salaries or wages. Backpay is unallowable except as follows:

(1) Payments to employees resulting from underpaid work actually performed are allowable, if required by a negotiated settlement, order, or court decree.

(2) Payments to union employees for the difference in their past and current wage rates for working without a contract or labor agreement during labor management negotiation are allowable.

(3) Payments to nonunion employees based upon results of union agreement negotiation are allowable only if—

(i) A formal agreement or understanding exists between management and the employees concerning these payments; or

(ii) An established policy or practice exists and is followed by the contractor so consistently as to imply, in effect, an agreement to make such payments.

(i) Compensation based on changes in the prices of corporate securities or corporate security ownership, such as stock options, stock appreciation rights, phantom stock plans, and junior stock conversions.

(1) Any compensation which is calculated, or valued, based on changes in the price of corporate securities is unallowable.

(2) Any compensation represented by dividend payments or which is calculated based on dividend payments is unallowable.

(3) If a contractor pays an employee in lieu of the employee receiving or exercising a right, option, or benefit which would have been unallowable under this paragraph (i), such payments are also unallowable.

(j) *Pension costs*. (1) Pension plans are normally segregated into two types of plans: defined-benefit and defined-contribution pension plans. The contractor shall measure, assign, and allocate the costs of all defined-benefit pension plans and the costs of all defined-contribution pension plans in compliance with 48 CFR 9904.412—Cost Accounting Standard for Composition and Measurement of Pension Cost, and 48 CFR 9904.413—Adjustment and Allocation of Pension Cost. Pension costs are allowable subject to the referenced standards and the cost limitations and exclusions set forth in paragraph (j)(1)(i) and in paragraphs (j)(2) through (j)(6) of this subsection.

(i) Except for nonqualified pension plans using the pay-as-you-go cost method, to be allowable in the current year, the contractor shall fund pension costs by the time set for filing of the Federal income tax return or any extension. Pension costs assigned to the current year, but not funded by the tax return time, are not allowable in any subsequent year. For nonqualified pension plans using the pay-as-you-go method, to be allowable in the current

year, the contractor shall allocate pension costs in the cost accounting period that the pension costs are assigned.

(ii) Pension payments must be paid pursuant to an agreement entered into in good faith between the contractor and employees before the work or services are performed and to the terms and conditions of the established plan. The cost of changes in pension plans are not allowable if the changes are discriminatory to the Government or are not intended to be applied consistently for all employees under similar circumstances in the future.

(iii) Except as provided for early retirement benefits in paragraph (j)(6) of this subsection, one-time-only pension supplements not available to all participants of the basic plan are not allowable as pension costs, unless the supplemental benefits represent a separate pension plan and the benefits are payable for life at the option of the employee.

(iv) Increases in payments to previously retired plan participants covering cost-of-living adjustments are allowable if paid in accordance with a policy or practice consistently followed.

(2) *Defined-benefit pension plans.* The cost limitations and exclusions pertaining to defined-benefit plans are as follows:

(i)(A) Except for nonqualified pension plans, pension costs (see 48 CFR 9904.412-40(a)(1)) assigned to the current accounting period, but not funded during it, are not allowable in subsequent years (except that a payment made to a fund by the time set for filing the Federal income tax return or any extension thereof is considered to have been made during such taxable year). However, any portion of pension cost computed for a cost accounting period, that exceeds the amount required to be funded pursuant to a waiver granted under the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), will be allowable in those future accounting periods in which the funding of such excess amounts occurs (see 48 CFR 9904.412-50(c)(5)).

(B) For nonqualified pension plans, except those using the pay-as-you-go cost method, allowable costs are lim-

ited to the amount allocable in accordance with 48 CFR 9904.412-50(d)(2).

(C) For nonqualified pension plans using the pay-as-you-go cost method, allowable costs are limited to the amounts allocable in accordance with 48 CFR 9904.412-50(d)(3).

(ii) Any amount funded in excess of the pension cost assigned to a cost accounting period is not allowable in that period and shall be accounted for as set forth at 48 CFR 9904.412-50(a)(4). The excess amount is allowable in the future period to which it is assigned, to the extent it is not otherwise unallowable.

(iii) Increased pension costs are unallowable if the increase is caused by a delay in funding beyond 30 days after each quarter of the year to which they are assignable. If a composite rate is used for allocating pension costs between the segments of a company and if, because of differences in the timing of the funding by the segments, an inequity exists, allowable pension costs for each segment will be limited to that particular segment's calculation of pension costs as provided for in 48 CFR 9904.413-50(c). The contractor shall make determinations of unallowable costs in accordance with the actuarial method used in calculating pension costs.

(iv) The contracting officer will consider the allowability of the cost of indemnifying the Pension Benefit Guaranty Corporation (PBGC) under ERISA section 4062 or 4064 arising from terminating an employee deferred compensation plan on a case-by-case basis, provided that if insurance was required by the PBGC under ERISA section 4023, it was so obtained and the indemnification payment is not recoverable under the insurance. Consideration under the foregoing circumstances will be primarily for the purpose of appraising the extent to which the indemnification payment is allocable to Government work. If a beneficial or other equitable relationship exists, the Government will participate, despite the requirements of 31.205-19(c)(3) and (d)(3), in the indemnification payment to the extent of its fair share.

(v) Increased pension costs resulting from the withdrawal of assets from a pension fund and transfer to another

employee benefit plan fund, or transfer of assets to another account within the same fund, are unallowable except to the extent authorized by an advance agreement. If the withdrawal of assets from a pension fund is a plan termination under ERISA, the provisions of paragraph (j)(3) of this subsection apply. The advance agreement shall—

(A) State the amount of the Government's equitable share in the gross amount withdrawn or transferred; and

(B) Provide that the Government receives a credit equal to the amount of the Government's equitable share of the gross withdrawal or transfer.

(3) *Pension adjustments and asset reversions.* (i) For segment closings, pension plan terminations, or curtailment of benefits, the amount of the adjustment shall be—

(A) For contracts and subcontracts that are subject to full coverage under the Cost Accounting Standards (CAS) Board rules and regulations, the amount measured, assigned, and allocated in accordance with 48 CFR 9904.413-50(c)(12); and

(B) For contracts and subcontracts that are not subject to full coverage under the CAS, the amount measured, assigned, and allocated in accordance with 48 CFR 9904.413-50(c)(12), except the numerator of the fraction at 48 CFR 9904.413-50(c)(12)(vi) is the sum of the pension plan costs allocated to all non-CAS-covered contracts and subcontracts that are subject to Subpart 31.2 or for which cost or pricing data were submitted.

(ii) For all other situations where assets revert to the contractor, or such assets are constructively received by it for any reason, the contractor shall, at the Government's option, make a refund or give a credit to the Government for its equitable share of the gross amount withdrawn. The Government's equitable share shall reflect the Government's participation in pension costs through those contracts for which cost or pricing data were submitted or that are subject to Subpart 31.2. Excise taxes on pension plan asset reversions or withdrawals under this paragraph (j)(3)(ii) are unallowable in accordance with 31.205-41(b)(6).

(4) *Defined-contribution pension plans.* In addition to defined-contribution

pension plans, this paragraph also covers profit sharing, savings plans, and other such plans, provided the plans fall within the definition of a pension plan at 31.001.

(i) Allowable pension cost is limited to the net contribution required to be made for a cost accounting period after taking into account dividends and other credits, where applicable. However, any portion of pension cost computed for a cost accounting period that exceeds the amount required to be funded pursuant to a waiver granted under the provisions of ERISA will be allowable in those future accounting periods in which the funding of such excess amounts occurs (see 48 CFR 9904.412-50(c)(5)).

(ii) The provisions of paragraphs (j)(2)(ii) and (iv) of this subsection apply to defined-contribution plans.

(5) *Pension plans using the pay-as-you-go cost method.* When using the pay-as-you-go cost method, the contractor shall measure, assign, and allocate the cost of pension plans in accordance with 48 CFR 9904.412 and 9904.413. Pension costs for a pension plan using the pay-as-you-go cost method are allowable to the extent they are not otherwise unallowable.

(6) *Early retirement incentives.* An early retirement incentive is an incentive given to an employee to retire early. For contract costing purposes, costs of early retirement incentives are allowable subject to the pension cost criteria contained in paragraphs (j)(2)(i) through (iv) of this subsection provided—

(i) The contractor measures, assigns, and allocates the costs in accordance with the contractor's accounting practices for pension costs;

(ii) The incentives are in accordance with the terms and conditions of an early retirement incentive plan;

(iii) The contractor applies the plan only to active employees. The cost of extending the plan to employees who retired or were terminated before the adoption of the plan is unallowable; and

(iv) The present value of the total incentives given to any employee in excess of the amount of the employee's annual salary for the previous fiscal year before the employee's retirement

is unallowable. The contractor shall compute the present value in accordance with its accounting practices for pension costs. The contractor shall account for any unallowable costs in accordance with 48 CFR 9904.412-50(a)(2).

(k) *Deferred compensation other than pensions.* (1) Deferred compensation is an award given by an employer to compensate an employee in a future cost accounting period or periods for services rendered in one or more cost accounting periods before the date of receipt of compensation by the employee. Deferred compensation does not include the amount of year-end accruals for salaries, wages, or bonuses that are paid within a reasonable period of time after the end of a cost accounting period. Subject to 31.205-6(a), deferred awards are allowable when they are based on current or future services. Awards made in periods subsequent to the period when the work being remunerated was performed are not allowable.

(2) The costs of deferred awards shall be measured, allocated, and accounted for in compliance with the provisions of 48 CFR 9904.415, Accounting for the Cost of Deferred Compensation.

(3) Deferred compensation payments to employees under awards made before the effective date of 48 CFR 9904.415 are allowable to the extent they would have been allowable under prior acquisition regulations.

(l) *Compensation incidental to business acquisitions.* The following costs are unallowable:

(1) Payments to employees under agreements in which they receive special compensation, in excess of the contractor's normal severance pay practice, if their employment terminates following a change in the management control over, or ownership of, the contractor or a substantial portion of its assets.

(2) Payments to employees under plans introduced in connection with a change (whether actual or prospective) in the management control over, or ownership of, the contractor or a substantial portion of its assets in which those employees receive special compensation, which is contingent upon the employee remaining with the contractor for a specified period of time.

(m) *Fringe benefits.* (1) Fringe benefits are allowances and services provided by the contractor to its employees as compensation in addition to regular wages and salaries. Fringe benefits include, but are not limited to, the cost of vacations, sick leave, holidays, military leave, employee insurance, and supplemental unemployment benefit plans. Except as provided otherwise in subpart 31.2, the costs of fringe benefit are allowable to the extent that they are reasonable and are required by law, employer-employee agreement, or an established policy of the contractor.

(2) That portion of the cost of company-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable regardless of whether the cost is reported as taxable income to the employees (see 31.205-46(d)).

(n) *Employee rebate and purchase discount plans.* Rebates and purchase discounts, in whatever form, granted to employees on products or services produced by the contractor or affiliates are unallowable.

(o) *Postretirement benefits other than pensions (PRB).* (1) PRB covers all benefits, other than cash benefits and life insurance benefits paid by pension plans, provided to employees, their beneficiaries, and covered dependents during the period following the employees' retirement. Benefits encompassed include, but are not limited to, postretirement health care; life insurance provided outside a pension plan; and other welfare benefits such as tuition assistance, day care, legal services, and housing subsidies provided after retirement.

(2) To be allowable, PRB costs must be reasonable and incurred pursuant to law, employer-employee agreement, or an established policy of the contractor. In addition, to be allowable, PRB costs must also be calculated in accordance with paragraphs (o)(2)(i), (ii), or (iii) of this section.

(i) *Cash basis.* Cost recognized as benefits when they are actually provided, must be paid to an insurer, provider, or other recipient for current year benefits or premiums.

(ii) *Terminal funding.* If a contractor elects a terminal-funded plan, it does

not accrue PRB costs during the working lives of employees. Instead, it accrues and pays the entire PRB liability to an insurer or trustee in a lump sum upon the termination of employees (or upon conversion to such a terminal-funded plan) to establish and maintain a fund or reserve for the sole purpose of providing PRB to retirees. The lump sum is allowable if amortized over a period of 15 years.

(iii) *Accrual basis.* Accrual costing other than terminal funding must be measured and assigned according to Generally Accepted Accounting Principles and be paid to an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing PRB to retirees. The accrual must also be calculated in accordance with generally accepted actuarial principles and practices as promulgated by the Actuarial Standards Board.

(3) To be allowable, costs must be funded by the time set for filing the Federal income tax return or any extension thereof. PRB costs assigned to the current year, but not funded or otherwise liquidated by the tax return time, shall not be allowable in any subsequent year.

(4) Increased PRB costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable.

(5) Costs of postretirement benefits in paragraph (o)(2)(iii) of this section attributable to past service ("transition obligation") as defined in Financial Accounting Standards Board Statement 106, paragraph 110, are allowable subject to the following limitation: The allowable amount of such costs assignable to a contractor fiscal year cannot exceed the amount of such costs which would be assigned to that contractor fiscal year under the delayed recognition methodology described in paragraphs 112 and 113 of Statement 106.

(6) The Government shall receive an equitable share of any amount of previously funded PRB costs which revert or inure to the contractor. Such equitable share shall reflect the Government's previous participation in PRB costs through those contracts for which cost or pricing data were re-

quired or which were subject to subpart 31.2.

(p) *Limitation on allowability of compensation for certain contractor personnel.*

(Note that pursuant to Section 804 of Pub. L. 105-261, the definition of "senior executive" in (p)(2)(ii) has been changed for compensation costs incurred after January 1, 1999.)

(1) Costs incurred after January 1, 1998, for compensation of a senior executive in excess of the benchmark compensation amount determined applicable for the contractor fiscal year by the Administrator, Office of Federal Procurement Policy (OFPP), under Section 39 of the OFPP Act (41 U.S.C. 435) are unallowable (10 U.S.C. 2324(e)(1)(P) and 41 U.S.C. 256(e)(1)(P)). This limitation is the sole statutory limitation on allowable senior executive compensation costs incurred after January 1, 1998, under new or previously existing contracts. This limitation applies whether or not the affected contracts were previously subject to a statutory limitation on such costs.

(2) As used in this paragraph—

(i) *Compensation* means the total amount of wages, salary, bonuses, deferred compensation (see paragraph (k) of this subsection), and employer contributions to defined contribution pension plans (see paragraphs (j)(4) and (q) of this subsection), for the fiscal year, whether paid, earned, or otherwise accruing, as recorded in the contractor's cost accounting records for the fiscal year.

(ii) *Senior executive* means—

(A) Prior to January 2, 1999—

(1) The Chief Executive Officer (CEO) or any individual acting in a similar capacity at the contractor's headquarters;

(2) The four most highly compensated employees in management positions at the contractor's headquarters, other than the CEO; and

(3) If the contractor has intermediate home offices or segments that report directly to the contractor's headquarters, the five most highly compensated employees in management positions at each such intermediate home office or segment.

(B) Effective January 2, 1999, the five most highly compensated employees in management positions at each home

office and each segment of the contractor, whether or not the home office or segment reports directly to the contractor's headquarters.

(iii) *Fiscal year* means the fiscal year established by the contractor for accounting purposes.

(iv) *Contractor's headquarters* means the highest organizational level from which executive compensation costs are allocated to Government contracts.

(q) *Employee stock ownership plans (ESOP)*. (1) An ESOP is a stock bonus plan designed to invest primarily in the stock of the employer corporation. The contractor's contributions to an Employee Stock Ownership Trust (ESOT) may be in the form of cash, stock, or property.

(2) Costs of ESOPs are allowable subject to the following conditions:

(i) For ESOPs that meet the definition of a pension plan at 31.001, the contractor—

(A) Measures, assigns, and allocates the costs in accordance with 48 CFR 9904.412;

(B) Funds the pension costs by the time set for filing of the Federal income tax return or any extension. Pension costs assigned to the current year, but not funded by the tax return time, are not allowable in any subsequent year; and

(C) Meets the requirements of paragraph (j)(2)(ii) of this subsection.

(ii) For ESOPs that do not meet the definition of a pension plan at 31.001, the contractor measures, assigns, and allocates costs in accordance with 48 CFR 9904.415.

(iii) Contributions by the contractor in any one year that exceed the deductibility limits of the Internal Revenue Code for that year are unallowable.

(iv) When the contribution is in the form of stock, the value of the stock contribution is limited to the fair market value of the stock on the date that title is effectively transferred to the trust.

(v) When the contribution is in the form of cash—

(A) Stock purchases by the ESOT in excess of fair market value are unallowable; and

(B) When stock purchases are in excess of fair market value, the contractor shall credit the amount of the

excess to the same indirect cost pools that were charged for the ESOP contributions in the year in which the stock purchase occurs. However, when the trust purchases the stock with borrowed funds which will be repaid over a period of years by cash contributions from the contractor to the trust, the contractor shall credit the excess price over fair market value to the indirect cost pools pro rata over the period of years during which the contractor contributes the cash used by the trust to repay the loan.

(vi) When the fair market value of unissued stock or stock of a closely held corporation is not readily determinable, the valuation will be made on a case-by-case basis taking into consideration the guidelines for valuation used by the IRS.

[48 FR 42301, Sept. 19, 1983]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting section 31.205-6, see the List of CFR Sections Affected which appears in the Finding Aids section of the printed volume and on GPO Access.

31.205-7 Contingencies.

(a) *Contingency*, as used in this subpart, means a possible future event or condition arising from presently known or unknown causes, the outcome of which is indeterminable at the present time.

(b) Costs for contingencies are generally unallowable for historical costing purposes because such costing deals with costs incurred and recorded on the contractor's books. However, in some cases, as for example, terminations, a contingency factor may be recognized when it is applicable to a past period to give recognition to minor unsettled factors in the interest of expediting settlement.

(c) In connection with estimates of future costs, contingencies fall into two categories:

(1) Those that may arise from presently known and existing conditions, the effects of which are foreseeable within reasonable limits of accuracy; e.g., anticipated costs of rejects and defective work. Contingencies of this category are to be included in the estimates of future costs so as to provide the best estimate of performance cost.